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SIPDIS

DEPT FOR EUR/ERA AND EUR/SCE, TREASURY FOR INTERNATIONAL
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SUBJECT: CMC STEEL: LARGEST U.S. INVESTMENT IN CROATIA
STRUGGLES THROUGH ECONOMIC CRISIS

1. Summary: With the buyout of Barr Pharmaceuticals by the Israeli firm Teva, the Houston-based Commercial Metals Corporation of Sisak is now the largest U.S. investment in Croatia. The mill employs roughly 1,000 people, making it also one of the largest employers in this central Croatian town of 50,000 people just 25 miles south of Zagreb. Despite continuous bureaucratic hurdles and poor market conditions, CMC is able to turn out high-quality forged seamless steel pipes and other products, primarily for the oil and gas industry. Unfortunately, the mill has only one month's worth of orders to fill -- a large order destined for the Algerian oil and gas industry -- and no others on the horizon. Despite the dismal market conditions, CMC continues to look to the future and has just broken ground on a new state of the art melting facility for conversion of scrap metal into raw steel. CMC told us they are on good terms with the local government, although they complain about a business climate still stifled by heavy bureaucratic involvement and a widespread "socialist era" mindset. End Summary

Trying to Make Money, not Launder it

2. Econoff and Commercial Counselor visited the CMC steel mill in Sisak on June 1. First opened in 1938 as the Sisak Steel Mill, the series of mills and plants occupying semi-forested land outside of Sisak employed 14,000 people at its peak. The massive complex now employs a much more modest 1,000 people, which still makes CMC one of the largest employers in the area. CMC has consolidated its operations to a smaller number of products on production lines occupying only a small fraction of the available space in the mills, the rest taken up by large spaces filled with rusting machinery or piles of scrap metal. Despite aging technology, CMC has the capacity to produce 8,000 tons of high-quality steel pipe monthly (although with current market conditions, actual production is significantly less).

3. Despite the reduced number of employees, the workers with whom we spoke were very positive about the direction of the mill. Our guide through the complex, a 15 year veteran who started as a welder and now works in the marketing office, told us she had planned to emigrate to Canada prior to the CMC takeover but changed her mind after the takeover. "I like that the Americans are interested in making money," she told us. "The previous managers were simply interested in laundering money."

Undercut by the Chinese

4. While the goal may be to make money, CMC Sisak has not yet made a profit. Its business and investment plan has stayed on track, however, thanks to strong markets in the oil

and gas industry of North Africa, primarily Algeria. These markets have withered somewhat with the fall in world oil prices, and the mill's General Manager admitted to us they have no orders after the current one, which will be completed in approximately one month. The situation would be even more dire were it not for an anti-dumping ruling in the U.S. against China, which makes CMC products competitive on U.S. markets (although also increasing the volume of cheap Chinese product on markets elsewhere). Managers told us competition from China is still their biggest worry, with the Chinese routinely offering finished product for the cost of CMC's raw materials.

The Bureaucracy is Still Heavy, but Improving

¶5. In the past year, CMC has struggled with several bureaucratic headaches, including onerous and long-delayed permitting procedures for its new melting facility, a dispute over interest payments on taxes owed by the previous owners, and negotiations with the government to change certain stipulations in its purchase agreement to facilitate the company's investment plan. The GM told us relations with the government are improving. Permits are complete for the expansion, and the company has achieved at least a partial solution with the government on the back taxes issue. Nevertheless, CMC officials complained about a lingering "socialist mindset" in which the bureaucracy, whether by accident or design, still has a large role to play in determining winners and losers in the economy.

¶6. COMMENT: In a market in which many businesses are taking on loans simply to cover operating expenses, it is

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encouraging to see a U.S. company committed to its investment, and moving forward with its plans for the future even in highly unfavorable conditions. It is too early to say that normal market forces, rather than a stifling bureaucracy, are now the central risks to a business in Croatia. But we are hopeful that once the world economy begins to revive, CMC Metals will be a success story of U.S. investment and a standard bearer for U.S. business practices in the region. END COMMENT.
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